

MEMORANDUM

Finance Department



DATE: September 28, 2018

TO: Mayor and City Council

THROUGH: Julie Edmonds-Mares, City Manager

FROM: Wil Fuentes, Director of Financial Services
Tony Ndah, Director of Public Works

SUBJECT: Recommended Deferral of Cost Allocation Plan and Sewer Rate Study Draft Reports

This staff memorandum provides information about the Administration's recommended deferral of October 2, 2018 City Council Meeting Agenda item #5 (Adopt a Resolution Approving the Fiscal Year 2018-19 Central Services Full Cost Allocation Plan Update) and item #6 (Receive Report on the Draft Sewer Rate Study and Provide Direction to Staff As Appropriate on the Sewer Rate Structure for a Five Year Period, FY 2018-19 to FY 2022-23).

Background:

At the September 18, 2018 meeting, City Council received reports from staff to A) Adopt a Resolution Approving the Fiscal Year 2018-19 Central Services Full Cost Allocation Plan Update; and B) Receive Report on the Draft Sewer Rate Study and Provide Direction to Staff As Appropriate on the Sewer Rate Structure for a Five Year Period, FY 2018-19 to FY 2022-23.

Cost Allocation Plan

During this meeting, City Council directed staff to conduct additional outreach to the community concerning the Cost Allocation Plan (CAP). Staff was also directed to ensure members of the former Water Rates Task Force received copies of the report since the prior Council direction to assess the CAP methodology was based on a request from the former Water Rates Task Force. Council also expressed interest in having a more robust and comprehensive discussion concerning the impact of the CAP on the Sewer and Water rate studies.

On September 24, staff along with the City's CAP consultant, presented the CAP update to the Finance Subcommittee, which was attended by several members of the former Water Rates Task Force; upon staff invitation to the entire membership of the former Water Rates Task Force. Announcement of the Finance Subcommittee meeting was also posted for public view on the City's Twitter and Facebook page. Several members of the former Water Rates Task Force attended and one additional member of the public attended. During the meeting, staff and the City's CAP consultant provided a presentation similar to the one that was shared with City Council during the September 18 meeting and also addressed any questions and concerns from the Subcommittee, the public and former Water Rates Task Force members in attendance. Although the indirect cost allocation to sewer funds will decrease with the proposed CAP, it is important to note that sewer rates are a function of many components and thus, having a lower indirect cost allocation is not anticipated to result in lower sewer rates, due to other components.

One concern raised by a member of the former Water Rates Task Force was that the draft updated CAP did not fully explain each allocation basis used. Thus, staff will work with the City's CAP consultant to expand upon allocation basis descriptions so that they are more detailed, more

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transparent, and easier to understand. Another concern raised by a member of the former Water Rates Task Force is that the City does not use a timecard system to charge indirect central services costs for areas such as Finance, Human Resources, the City Manager's Office, City Council, etc. It was further stated by the member that the City of Sunnyvale uses a timecard system to track this time. Staff has spoken directly with the Finance Director at the City of Sunnyvale and similar to the City of Milpitas, Sunnyvale uses a cost allocation process to assign indirect central services costs and only uses a timecard system to track employee time worked on capital projects such as streets resurfacing. A final concern raised by a member of the former Water Rates Task Force was that the City may not be properly assigning direct costs for areas such as Utilities Maintenance and Utilities Billing between the Water and Sewer Funds. While this is outside the scope of a cost allocation plan which addresses indirect costs only, staff did explain its current method of assigning direct costs. The City currently estimates this time annually through discussion during the budget development process and assigns a predetermined percentage of employee time each payroll period to the Water and Sewer Funds. Staff will explore whether directly tracking the time of those employees in Utilities Maintenance, Utilities Billing, and other direct cost areas via a new automated timecard process each payroll period would be beneficial and produce greater accuracy. An organizational assessment of the Public Works department currently underway will help in this effort.

Sewer Rate Study

At the September 18, 2018 Council meeting, Council also directed staff to work with the City of San Jose to explore options to update San Jose's 2015 Residential Flow Study with updated sewer flow numbers for mobile home park customers in Milpitas. In order to ensure costs are distributed to all customer classes in accordance with Propositions 218 and 26, the study had recommended aligning the sewer rate structure for the mobile home parks with values used in San Jose's 2015 Residential Flow Study (i.e. 141 gallons per day per unit, as opposed to the 114 gallons per day per unit). This would have resulted in an increase to the mobile home park bi-monthly service charge by 32% in FY 2019. Recognizing the significant impact of this increase, staff had proposed a mobile home park rate subsidy from unrestricted funds over a 5-year period. Council directed staff to conduct outreach to the mobile home parks and also directed staff to explore subsidy programs for disadvantaged sewer customers. The draft sewer rate study assumed the need for external financing to pay for the City's contribution to the rehabilitation of the San Jose/Santa Clara Regional Wastewater Facility. Some Councilmembers expressed an interest in receiving additional information on financing options such as types of bonds being considered for financing, including bonds that would need voter approval, and an Enhanced Infrastructure Financing District (EIFD).

Current Status and Next Steps:

Cost Allocation Plan

- 1) Staff is working with the City's CAP Consultant to expand upon descriptions of each allocation basis used for indirect central services cost areas.
- 2) Finance staff will collaborate with the Public Works Department to assess whether direct costs are assigned appropriately to the Water and Sewer Funds and to implement corrections and systems where necessary to ensure proper allocation in the future.
- 3) Since the CAP is an integral component of Water and Sewer rates and any update must be factored into rate studies, staff will return to Council at a later date, before adoption of Water and Sewer rates, to consider adoption of the updated CAP.

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- 4) After further analysis and if it is determined necessary, staff will return to Council during mid-year budget adjustments to present final plans to offset any negative General Fund revenue impacts as a result of the updated CAP.
- 5) Staff will continue working on studies for fees charged to developers and other parties to fully capture City costs; both direct costs of service and indirect overhead costs. Such studies may help to mitigate any negative General Fund impacts resulting from an updated CAP. If studies result in revised recommended fees, they will be brought before Council for review and consideration in April/May 2019 and be included in revenue estimates for the FY 2019-20 Budget.

Sewer Rate Study

- 1) Staff has reached out to San Jose and will be discussing options to update San Jose's 2015 Flow Study for the City's Mobile home parks.
- 2) Staff will be conducting outreach to the mobile home community.
- 3) Staff will also be exploring additional subsidy programs that could be implemented for the City's disadvantaged sewer customers.
- 4) Staff will look into Council requests for financing options and come back with additional information and recommendations.

Staff respectfully requests and recommends deferral of item #5 and item #6 on the October 2, 2018 City Council Meeting Agenda to a future Council meeting, to allow staff the necessary time to complete the additional work outlined above on the CAP and Sewer Rate study.